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BANKING REFORM IN THE UNITED STATES

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Five years have passed since the panic of 1907 gave such a renewed impetus to the movement for banking reform as to cause a widespread expectation that a thoroughgoing reform soon would be effected. Aside, however, from the avowedly makeshift provisions of the so-called Aldrich-Vreeland Act, which expires by limitation June 30, 1914, and under which not a dollar of bank notes has yet been put into circulation, no legislative reform of consequence in our national banking system has been accomplished. In this statement I would emphasize the words *legislative* and *national*,—the first, because I would not belittle the reforms accomplished by the banks themselves through clearing house examiners, and the even greater reforms accomplished through the vigorously efficient administration of Comptroller Murray; the second, because I would not belittle the banking legislation enacted in many of our states since the panic of 1907.

In January, 1911, a tentative plan was presented to the public by Senator Aldrich, for criticism and suggestion. After nine months of discussion, the plan was resubmitted in a revised form in October; and, finally, in the shape of a third revision, it became the unanimous recommendation of the nonpartisan National Monetary Commission. A vigorous campaign of publicity and education has been waged for two years in support of the plan by the American Bankers' Association, the National Citizens' League, and other organizations, and large sums of money have been spent in the work of propaganda, yet advocates of banking reform are much less optimistic now¹ than they were two years ago. No political party, large or small, in the recent national campaign

¹ Compare for example the attitude taken by the American Bankers' Association on the Aldrich plan at its annual convention of 1912 with that taken in the convention of 1911. Mr. George M. Reynolds voiced a common sentiment among bankers, in his address before the 1912 convention, when he said: "If, however, any of you see anything in [the banking reform planks of the three great political parties] to encourage bankers in an honest effort to help provide a proper system of banking and currency . . . I should be glad to have you point it out." *Chronicle, Bankers' Convention Supplement*, September, 1912, p. 163.

put a plank into its platform advocating the National Monetary Commission's plan or anything resembling that plan. The Republican platform ignored the plan, probably in part, because it was the desire of the leaders to keep the question of banking reform out of the political arena. The banking planks of the Progressive party and the Democratic party admitted the need of banking reform but both declared their opposition positively to the so-called Aldrich plan. Probably no class of people in the community would benefit more from an adequate and sane banking reform than would our farmers, because their needs for currency and credit vary greatly with the seasons, and to them the seasonal inelasticity of our currency and bank credit is a continual and serious handicap. Currency and credit are scarce in the fall when the farmers need them most; and prices are most depressed by a stringent money market at the very time of the year that the farmers have most to sell. Yet throughout the country farmers have been generally either surprisingly indifferent or hostile to the Monetary Commission's plan.

One explanation of these facts stands out so prominently as to overtop all others. It is not disapproval of the functions assigned to the proposed National Reserve Association. Most people who have given the subject serious thought believe that any effective reform will require the assignment to some institution or institutions of a substantial part of the functions assigned to the National Reserve Association. Nor is the great obstacle fear of political complications. In the literature of opposition to the Aldrich plan, suggestions of this danger which proved so real in the case of the First and Second United States Banks, and which have played such an important rôle in subsequent agitation for a central bank, have been conspicuous for their comparative neglect. The great obstacle to the reform has been the fear that the National Reserve Association would be controlled and selfishly exploited by large financial interests. This fear was much strengthened by the facts that the plan seemed to many to be linked with conservative politics at a time when the *Zeitgeist* was strongly progressive, and that it bore the same name as did a most unpopular tariff act. The fact, moreover, that the plan of organization of the National Reserve Association is so complicated that few can or will understand it, places upon the plan a tremendous handicap when submitted to a public ultrasuspicious of financial interests because of recent abuses, and

hypersensitive because of fretting over the increasing cost of living.

Exploitation by special interests is feared because of two conditions: first, that the control of the proposed institution was to be put so largely into the hands of a special class in the community, that is, bankers; and, second, that among bankers themselves the real control might fall into the hands of those particular interests loosely characterized as "the money trust." The first danger I discussed at some length in a paper read at a meeting of the Western Economic Association a year ago,² and, with your permission, I will briefly summarize the conclusions there made by adapting a few passages from that paper:

Is not the National Reserve Association too much of a public institution to be so largely controlled by one type of business interest, that is, that of the banking fraternity? We must get away from the prevalent idea that the National Reserve Association is to be principally a banker's affair just because its capital is to be furnished entirely by banks. We must bear in mind that its public deposits alone will for some time probably exceed its paid-up capital, that the funds which the banks deposit with the Association will be chiefly those which the public has deposited with the banks, and that the paper which the banks rediscount with it will be that of the business community. We must not forget that the National Reserve Association is to have a tremendous public power and responsibility, through its right to fix the bank rate of discount, its power over the foreign exchanges and gold shipments, its right to issue the country's only elastic paper currency, its supervisory power over banks, and its function of holding a large percentage of the country's reserve money, together with the privilege of having its promises to pay, in the form of its deposits and bank notes, counted as lawful reserve money for banks.

Now it is possible, although by no means certain, that the interests of bankers as a class and those of the public are identical. It is certain, however, that history furnishes numerous instances in which what the public believed to be its interest and what bankers believed to be theirs were in conflict. One need not go back farther than the last two or three years to find a striking instance of the kind in the United States. I refer to the movement leading to the establishment of the United States postal saving depositories, which was opposed vigorously and almost unanimously by the banking fraternity.³ It is furthermore true, and perhaps of greater importance, that a large element in the

² "Some Public Aspects of the Aldrich Plan." *Journal of Political Economy*, December, 1911, pp. 819-830.

³ E. W. Kemmerer, "The United States Postal Savings Bank," *Political Science Quarterly*, xxvi (1911), pp. 474 and 475.

country believes the interests of bankers to be in conflict with those of the general public on a great many vital questions. The task of securing and maintaining a thoroughgoing banking reform is at best an arduous one, and the plan proposed must be not only intrinsically meritorious, but above suspicion. Otherwise it will have a difficult road in Congress, and if it finally gets through it will be in subsequent danger of becoming a football of politics.

If we turn to the great central banks of Europe, all of which are to a very large extent bankers' banks, we find that great care is taken to prevent them from falling into the control of the banking class of the community, or of any other special class.⁴

Not this fear of selfish exploitation in the interest of bankers as a class, however, but the fear of selfish exploitation by that group of financial interests popularly known as "Wall Street," has been the great obstacle to the progress of the National Monetary Commission's plan. The Democratic National platform this year, after specifically opposing the Monetary Commission's plan, advocated reform measures which would afford "protection" from control or domination by what is known as the "money trust;" the Progressive national platform declared that "the control [of the issue of currency] should be lodged with the government and should be protected from domination or manipulation by Wall Street or any special interests." Everywhere throughout the

'In Germany the ultimate control of the Reichsbank is in the imperial government, and is exercised by two boards, the Curatorium and the Directorium. The Curatorium is composed of five members. The imperial chancellor is chairman and he appoints one other member, while the Bundesrath (the upper house of the imperial legislature) appoints three members from its own numbers. The Directorium, consisting of nine members, two of whom are the president and vice-president of the Reichsbank, are all appointed by the emperor for life. In France the governor of the bank of France and the two sub-governors are named by a decree of the president of the Republic upon the proposal of the minister of finance, upon the presentation made to him of three candidates by the governor of the bank. In England the government has no voice in the management of the Bank of England, the supreme control resting with the governor of the bank, the deputy governor, and twenty-four directors who are elected annually by the stockholders. "There is no legal restriction as to the class from which directors may be selected, except that they must be 'natural-born subjects of England, or naturalized,' . . . in actual practice the selection is confined to those who are, or have been, members of mercantile or financial houses, excluding bankers, brokers, bill discounters, or directors of other banks" operating in the United Kingdom.—"Interviews on the Banking and Currency Systems of England, Scotland, France, Germany, etc." *National Monetary Commission's Report*, pp. 9-10.

country the advocates of the Monetary Commission's plan have been put on the defensive in the matter of Wall Street domination; and the fear of such domination appears to be growing.⁵

When told that Wall Street would have no incentive to use the National Reserve Association for the purpose of exploiting the public for the benefit of the "interests," since the maximum dividend the Association can pay is 5 per cent, the sceptic replies that it is not a question of immediate dividends but of power, and he points to the familiar fact that bank stocks as well as those of other corporations often sell at prices having no relationship whatever to present or prospective dividends—prices determined by the power over other interests which control over the one in question gives.

When told that the control of the National Reserve Association even if secured would give no such power, since the corporation cannot loan to the American public, cannot buy stocks or bonds (except government bonds), and cannot re-discount paper issued for the purpose of carrying stocks or bonds, the sceptic replies that the National Reserve Association has a tremendous power over the money market in its right to fix the American discount rate, to influence the foreign and domestic exchanges, to export and import gold, and to discriminate between banks in the matter of re-discounts and direct loans.

When confronted with elaborate figures to prove that "fear of possible Wall Street control can have no substantial foundation" because of the preponderating power given to the small banks scattered throughout the country, and because "the New York district with 29 per cent of the banking resources of the country would have [but] 8 per cent of the representation on the [central] board," the sceptic replies: Through our highly developed community of interest in financial matters, interlocking directorates, etc., a comparatively few men with headquarters in Wall Street directly and indirectly control practically all the leading banks, railroads, insurance companies, and industrial corporations of the country; that these large interests can and often do force the smaller and more remotely situated concerns to do their bidding. In substantiation of his contentions, the sceptic points to some of the striking revelations now being made by the Pujo Committee

⁵ The fear has been aggravated by the recent revelations in the matter of campaign contributions by large interests, and by the investigations being made of the "money trust" by the House Committee on Currency and Banking.

in the matter of financial centralization through community of interest; and if he is an independent business man he frequently points to the strong community of interest in his own town and to experiences of his own or his friends in trying to finance some worthy enterprise not countenanced by the money power in his town or by its dictators in the nearby metropolis.

When told that under the Monetary Commission's plan as last revised banks under a unified control, either by reason of direct ownership of one by another, or by reason of interlocking directorates, are shorn of most of their power, the sceptic looks wise, smiles, and thinks of dummy directors and similar devices.

When told that this community of interest of which he is complaining has grown up under our present decentralized banking system, and that its workings would be brought out into the open and regulated in the light of publicity by carefully drawn rules if the National Reserve Association were established, the sceptic replies: Yes, the present situation is bad enough, but the interests which we most fear, and which have been guilty of the worst abuses, are practically unanimous in favor of the proposed plan. He declares that their reasons are selfish, and that the plan once adopted and supported by the strong force of vested interests would clinch for years to come this dangerous power now possessed by the few.

These arguments are not imaginary. Every one of them I have heard repeatedly in conversation and seen in the press; and some such position, whether right or wrong, appears to be that of a large and probably growing percentage of intelligent people. The pressing question now is: What is to be done about it?

Inasmuch as the criticisms which are proving to be the real obstacles to the reform are directed mainly at the machinery of organization of the National Reserve Association, rather than at its functions, we may ask: Cannot the scheme of organization and control be modified so as to meet these criticisms without sacrificing the real virtues of the plan? In other words, are not the features to which so much objection is being made really non-essential? Is not the attainment of a thoroughgoing reform of such moment as to justify large concessions, in the matter of control, to public opinion, or, if you prefer, to public prejudice? I believe these questions demand an affirmative answer, and therefore would suggest the following modifications in the plan:

That the fact that the proposed National Reserve Association

is much more than a bankers' bank, that it is a great public trustee with tremendous powers and responsibilities, be frankly recognized; and that the non-banking interests be given a much larger part in its control. This seems particularly desirable in regard to the directorate of the Central Association, which will be concerned not with narrow questions of banking practice such as deposits, transfers, re-discounts, loans, and the like, but with broad questions of policy such as the discount rate, gold shipments, the size of the reserve, amount of note issue, etc. No banker (in the English sense of the word) can be a director of that great and predominantly bankers' bank, the Bank of England. Is there any sufficient reason why we in America should depart from the practice of Europe, and in the face of widespread suspicions insist on having forty-two out of the forty-six directors of the National Reserve Association, including the governor and the two deputy governors, appointed directly or indirectly by bankers? The present plan provides for the election by the branch boards composed chiefly of bankers and elected by bankers, of fifteen directors for the central board who "shall fairly represent the agricultural, commercial, industrial, and other interests of the district, and shall not be officers nor, while serving, directors of banks, trust companies, insurance companies or other financial institutions." Is it surprising that the farmers of the country should be sceptical of a plan claimed to be particularly beneficial to them, which provides for representatives of the agricultural interests of the country on the directorate, but insists that those agricultural representatives shall be appointed by boards whose members are all elected by bankers and about five sixths of whom are bankers?

Would not a provision for entrusting to the President of the United States the appointment of one of the deputy governors⁶ and all of the non-banking directors allay much of the popular suspicion which now stands in the way of the adoption of the plan, and at the same time insure a broader and better directorate for the performance of the Association's important public functions? These government directors should be appointed for a term of six years, one third of their number retiring every two years. At least one of them should be on the executive committee.

⁶A reduction in the number of directors of the Central Association is later suggested. P. 60.

The justification for the appointment of non-banking representatives on the directorates of the branch associations is not so strong as that for their appointment on the central board, because the branch boards are more occupied with narrow banking matters and less with broad questions of policy than is the central board. If, however, the branch boards are to have members, as provided in the present plan, who are to "fairly represent the agricultural, commercial, industrial, and other interests of the district," it would seem reasonable that these members should be appointed either by the interests they are supposed to represent or by some publicly elected body or official.

They should have a substantial representation on important committees. Obviously the danger of such an arrangement is that of drawing politics into the National Reserve Association. This political danger would be reduced to a minimum if one third of the members of the branch boards, instead of one sixth as at present, were made to represent the agricultural, commercial, industrial, and other interests of the district; and if these members were to be appointed by the governors of the states covered by the different branch associations. The governor of each state should appoint at least one non-banking director; and, when more than one was needed from a state to make the number of non-banking directors constitute one third of the board,⁷ the additional ones should be apportioned to the different states roughly according to the proportion of member banks in each state. For example, in the present plan one branch is to cover the six New England states. This would mean that if there were to be eighteen directors for the New England branch, in addition to the governor of the branch, twelve would be elected by the local associations and would be presumably bankers, and one would be appointed by the governor of each of the six New England states and would represent the non-banking interests of New England. Again, the four Eastern states are to have two branches. If New York and New Jersey comprised one of these branch districts, and if the directorate consisted of the minimum number allowed; that is, twelve in addition to the governor of the branch (section 8), four would be appointed by the governors of New York and New Jersey. In this case, probably three would be appointed by the governor of New York and one by the governor of New Jersey. **Appointments**

⁷ Exclusive of the governor of the branch.

should be made for six years, and, in case there were more than one appointee for a state, their terms of office should be arranged to expire at different times; for example, in the illustration above, for New York one at the end of every two years.

The next change in the plan of organization, I would suggest, would be to *give up entirely the idea of apportioning any voting power on the basis of capital stock, and to adopt the simple and democratic rule of one institution one vote*. This would mean that in the election of directors of the local associations each bank regardless of its size would have one vote for each director to be elected; likewise each local association, in the election of directors of the branch associations, and each branch association, in the election of directors of the Central Association. The change is for the purpose of reducing the danger and of lessening the fear of Wall Street exploitation. Incidentally it has the merit of removing some of the intricacies of the present plan, which are in themselves serious obstacles in the way of that plan's adoption.

In making the changes here proposed in the organization of the central board, it would be well to reduce the size of the board, from its present unwieldy number of forty-six to twenty-eight. The central board would then be comprised as follows: fifteen directors, one elected by each branch board, according to the democratic rule of one branch director one vote; six directors, appointed by the President of the United States for a term of six years, the appointments being made so that two would retire every two years; four ex-officio public officers, that is, the secretary of the treasury, the secretary of commerce and labor, the secretary of agriculture, and the comptroller of currency; one deputy governor to be appointed by the President of the United States; and the other deputy governor to be appointed by the board; the governor to be appointed as at present provided by the President of the United States, from a list of not less than three submitted to him by the board.

The reasonableness of a democratic plan of government for the association is perhaps best evidenced by the fact that such a plan has been voluntarily adopted and successfully followed by bankers in the one important organization in which banks work coöperatively. I refer, by way of analogy, to our American clearing houses—the most efficient in the world—with their great and growing powers and widening functions. In reply to an inquiry on this subject, the leading American authority on clearing houses, Mr.

James G. Cannon of New York, informs me that he knows of no clearing house in the country, although there may possibly be a few, whose voting power of members is apportioned with respect to the capital stock, or otherwise than on the basis of one vote to an institution. This is the rule of the New York Clearing House, where the same voting power is given to the Butchers' and Drovers' National Bank with a capital and surplus amounting to \$427,100 as to the National City Bank with a capital and surplus nearly a hundred and thirty times as large. Yet the bankers of New York have such confidence in the Clearing House Committee, which is elected by the Clearing House Association on the one institution one vote principle, that they vest it with "almost absolute power" including "the direction of practically the whole machinery of the Clearing House." The Clearing House Committee, we are told, is usually composed of from three to five members "chosen from the most capable and experienced bankers in the Association."⁸ The public hears little complaint that the interests of the large banks are not amply protected in the country's clearing house, or that inferior grades of men are elected in them to responsible positions.

In our present American banking systems, we have two organizations formed by the banks themselves which may exercise the functions of re-discount and of issue on the basis of what amounts to the joint guarantee of the member banks, privileges which are among the most important granted to the proposed National Reserve Association. I refer to the loan committees of our clearing houses which issue clearing house loan certificates, clearing house checks, etc., in times of emergency;⁹ and to the National Currency Associations authorized by the Aldrich-Vreeland Act of May 30, 1908. But both bodies are created and controlled on the principle of one bank one vote, regardless of the size of the bank. The clearing house loan committee is almost, if not quite, invariably either elected on the one bank one vote plan, or appointed by the president of the Clearing House Association, who is himself elected

* J. G. Cannon, "Clearing Houses." *National Monetary Commission's Report*, 1910, p. 32.

⁹ These certificates, checks, etc., perform the function of bank notes in clearing house settlements between banks, and have often been placed in general circulation. Their issue may not always be legal but they are readily tolerated by the authorities in time of crisis. See A. Piatt Andrew, "Substitutes for Cash in the Panic of 1907," *Quarterly Journal of Economics*, xxii (1908), pp. 504-510.

on that plan. This is true although the larger banks have greater responsibility in proportion to their greater funds, in what amounts practically to a joint guarantee of all the associated banks, of the loan certificates issued. This democratic principle of one bank one vote is even more pronounced¹⁰ in its application to the organization of the National Currency Associations, of which we now have seventeen, representing two hundred and eighty-four banks and one third of the capital and surplus of all the national banks in the country. These associations, which are open to any qualified national bank, large or small, in the city or territory where the association is organized, are managed by a board "consisting of one representative for each bank," and the officers and executive committee are elected by this board. The association issues to member banks emergency circulation, on the basis of satisfactory collateral deposited with the association, but the law makes all the banks jointly and severally liable for the redemption of such emergency circulation as between the banks composing the association. However, each is liable only "in the proportion that its capital and surplus bears to the aggregate capital and surplus of all such banks." Voting power is thus proportionate to numbers both in case of clearing house loan certificates and of the issue of emergency circulation of the National Currency Associations, while liability in both cases is in proportion to capital.

This democratic rule of voting is also applied in the Bank of England. Each shareholder owning £500 worth of stock has one vote, but no more than one vote, no matter how much additional stock he holds. Furthermore, English bankers cannot even become directors of the Bank of England. Yet they entrust to the bank practically their entire reserves, and have confidence in its exercise of most of the powers proposed to be given to the National Reserve Association.

The voting rule here proposed for the National Reserve Association is the rule of our American democracy, where we have long since discarded property qualifications for most of our voting; and although our legislative bodies, federal, state, and local, are continually legislating on questions of property, few careful students would maintain that property rights in America have not on the whole been adequately protected.

¹⁰ National currency associations do not have the power to exclude qualified banks from the privilege of membership which most clearing house associations possess. Cf. *Report of Comptroller of Currency*, 1910, p. 32.

We know that in the clearing house associations the big banks, with their powerful prestige and their highly capable officials, do exercise a power quite out of proportion to their numbers, just as the wealthy man politically exercises an influence which cannot be measured at all by the one man one vote rule. Can we doubt that under present conditions, or conditions as they are likely to be for many years to come in this country, the large banks in the National Reserve Association under the unit rule would exercise a power likewise out of proportion to their numbers?¹¹ Considering the limited functions of the National Reserve Association, and the numerous safeguards laid down, would the unit rule endanger the capital of the large banks, lead to incapable directors, or to dangerous methods? I have too high an opinion of the rank and file of American bankers to have misgivings upon any of these questions. At present it seems certain that without some such democratization the National Monetary Commission's plan cannot receive the support necessary to make it a law. Is not some further sacrifice of their own preferences by the big banks warranted even by their own interests, and infinitely more so as a matter of the public good?

During the two years in which the National Reserve Association plan has been before the public, its advocates have urged repeatedly and with great emphasis that the reform proposed was not only of great importance to the bankers, but of even greater importance to the business man, the farmer, and the laborer. They have denied that it was a scheme for centralization, and insisted that it was rather a plan for democratic coöperation, analogous to that of the clearing house or of our American system of government. A more democratic plan of organization would bring it into closer conformity to these claims. If the non-banking public has a great and paramount interest in the work the National Reserve Association is to do, why not give that non-banking public an effective say in the determination of its policies? If the organization is to be coöperative and democratic like that of our American clearing house, or of the American government, why not adopt the democratic rule of unit voting which prevails in clearing house and in government?

¹¹ It should furthermore be noted that the rule of the National Monetary Commission's plan, excluding from membership banks possessing a very small capital, will exclude approximately a third of the state banks of the country, all possessing capitals of less than \$25,000, and that in general the eligible banks which refuse to join will be the smaller banks.